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## Income tax guide: an analysis of the obligations imposed on individuals, firms and corporations by the federal income tax law, suggestions for making returns, and form for recording income

Walter A. Staub

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# INCOME TAX GUIDE

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NEW YORK PHILADELPHIA CHICAGO PITTSBURGH  
SAN FRANCISCO SEATTLE LONDON

# INCOME TAX GUIDE

AN ANALYSIS OF THE OBLIGATIONS IMPOSED ON  
INDIVIDUALS, FIRMS AND CORPORATIONS  
BY THE FEDERAL INCOME TAX LAW  
SUGGESTIONS FOR MAKING RETURNS  
AND  
FORM FOR RECORDING INCOME

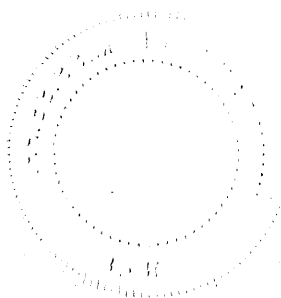
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1913



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## **INCOME TAX GUIDE**

The obligations imposed by the far reaching income tax law which has just been enacted may be broadly separated between those imposed on Individuals and those imposed on Corporations.

### **OBLIGATIONS IMPOSED ON INDIVIDUALS**

The obligations of the individual may be summarized as follows:

1. He must submit an annual return, i. e. report, to the Federal Government of his net income.
2. He must pay the tax levied on the net income so reported.
3. He must withhold and pay over to the Federal Government the income tax on certain kinds of payments which he makes to others (such as rent exceeding \$3,000 per annum paid to an individual) and he must make a report to the Government of the taxes so withheld.

### **How Net Income of Individuals is to be Computed**

The form in which the return is to be made is to be fixed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury but the essential features are prescribed by the law itself. The net income of an individual is to be determined by subtracting from his gross income the deductions for expenses and losses, as hereinafter explained:

**Gross Income:** Includes gains, profits, and income derived from

- Salaries, wages or compensation for personal service;
- Professions, vocations, businesses, trade, commerce or sales or dealings in property, whether real or personal;
- Interest, rent, dividends;
- The transaction of any lawful business carried on for gain or profit;
- Any other source.



Gross Income includes the income from, but not the value of, property acquired by gift or inheritance. It does not include proceeds of life insurance policies paid upon death of the person insured, nor that part of amounts received on maturity or surrender of life, endowment or annuity policies which represents a return of premiums paid thereon.

The following are allowable

**Deductions from Gross Income:**

1. Necessary business expenses, not including personal, living or family expenses.
2. All interest on indebtedness.
3. All taxes, not including assessments for local benefits (paving, sewers, etc.).
4. Losses actually sustained during the year, incurred in trade or arising from fires, storms or shipwreck, and not compensated for by insurance or otherwise.
5. Debts due to the taxpayer actually ascertained to be worthless and charged off within the year.
6. A reasonable allowance for exhaustion, wear and tear of property arising out of its use in the business, not exceeding in the case of mines 5 pct. of the gross value at the mine of the year's output.  
(No deduction will be allowed for expenditures for new buildings, permanent improvements or betterments made to increase the value of any property.)
7. Dividends from corporations which are subject to a tax on their net income.
8. Income on which the tax has been withheld at its source.

**Taxable Income of Aliens**

A citizen of a foreign country who is a resident of the United States is taxable on his entire net income, computed as above, including his income from investments in other countries.

A person residing abroad, who is not a citizen of the United States, is taxable on his entire net income from all property owned and from business, trade or profession

carried on in the United States, not including, however, interest on bonds of American corporations or on other indebtedness to such person. The taxable net income of such a person is to be computed on the same basis as the foregoing, excepting that the gross income is to be restricted to that derived from sources within the United States, and on the other hand the deductions shall be limited to those pertaining to business done within the United States.

### **Exemptions**

Income from the following sources is exempt from the income tax:

Interest on bonds or other obligations of the United States or its possessions, of a State or any political subdivision thereof (counties, municipalities, school districts, etc.).

Salary of the President of the United States during the present term.

Salaries of federal judges now in office.

Salaries of all officers and employees of a State or political subdivision thereof.

Special compensation paid by States or subdivisions thereof for professional services, whether in the shape of salaries or special fees.

The first \$3,000 of net income is exempt from the tax. In the case of a married man whose wife lives with him the next \$1,000 of net income is also exempt from the tax. The latter exemption also applies in the case of a married woman whose husband is living with her. Only \$4,000 may, however, be deducted from the aggregate income of husband and wife when living together.

### **Suggestions Regarding Returns**

The following suggestions are made for the treatment of various questions which may arise in preparing the returns until such time as the Commissioner of Internal Revenue makes rulings on the various points mentioned:

**Unincorporated Businesses:** Persons conducting unincorporated businesses, particularly manufacturing enterprises, should familiarize themselves with the returns required of corporations (which are dealt with further on in this article) because the regulations to be prescribed by the Commissioner of Internal Revenue for personal returns will probably be more or less in harmony with those prescribed for corporations, so far as regards the reporting of business operations.

Unfortunately the law makes no provision for personal returns of unincorporated businesses to cover the fiscal year instead of the calendar year when the two do not coincide. Consequently, where this is the case with a manufacturing plant operated by an individual or a partnership, the same difficulty and inconvenience in the making of the return will be encountered as was experienced by corporations under the corporation tax law.

In reporting business operations merely the gross profits therefrom, for example, the excess of the sales over the cost of goods sold, should be entered as gross income. The cost of goods sold will represent either the cost by purchase from others or by manufacture in the person's own plant but must not include (1) selling and general expense, (2) interest, (3) taxes, (4) losses by fire, storm or shipwreck or on (5) uncollectible accounts, or (6) depreciation of plant, mines or other property. Such expenses, losses or depreciation should be entered as deductions under the respective number prefixed to the classes of expenses or losses above mentioned.

**Are Expenses to be based on Actual Disbursements?**

The use of the word "paid" (specified in the law as the basis of the deductions to be allowed for expenses, interest and taxes) is apparently an unfortunate inheritance from the corporation tax law. The deductions should logically be based on "expenses incurred," "interest accrued" and "taxes accrued," as one's gross income is really diminished

by expenses, interest and taxes when they are incurred or accrue and not when they are paid, as the payment may for various reasons not take place until a subsequent year.

If this requirement of the law is literally enforced, individuals conducting manufacturing enterprises will be very much inconvenienced in preparing returns, as the operating accounts of all well conducted businesses are based not on cash received and paid but on gross income earned and expenses incurred irrespective of the date of settlement. However, the Treasury Department will probably take the position with respect to this law that it did with the 1909 corporation tax law when it made the ruling that the word "paid" did not mean paid in cash but would be construed to include all expenses entered on a corporation's books irrespective of when paid.

In passing it may be noted that under the corporation tax law whenever corporations found it to their advantage to insist on the literal wording of the law, which called for a return based on receipts and payments, the courts sustained them.\* Of course, most corporations found it much more convenient to comply with the Treasury Department's executive modification of the law than to prepare their returns on the cash basis.

**Professional Men's Returns:** A professional man practicing in his individual capacity and not as a member of a partnership should enter his gross income as such and take credit under the first deduction for such expenses as office rent, clerical salaries, supplies, etc., which are connected with the practice of his profession.

Certain professional men, such as doctors and country lawyers, maintain their offices in their homes. It is a question whether in such a case they should not be permitted to deduct from their gross income a part of the rent paid for the house, if they are living in leased buildings. An application under the British income tax act by a clergy-

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\* See *Mutual Benefit Life Insurance Co. vs. Herold*, 198 Fed. 199.

man for the deduction of the rental value of his study from his income (which was granted) may be cited as an interesting English precedent.\*

A doctor would seem to be entitled to deduct the expenses of maintaining an automobile or a horse and carriage for exclusive use in his practice and the cost of drugs and other supplies as necessary business expenses.

**Investors and Others:** A person who is not actively or directly engaged in either manufacturing or mercantile business but who nevertheless maintains an office away from his home should take credit under the first deduction for the rent, clerk hire and other expenses of the office, as they may very properly be termed business expenses.

It would also seem that a person who does not maintain an office away from his home but who has, for instance, a private secretary to look after his investments and similar business matters should be permitted to include the secretary's salary and any other expenses directly connected with the care of his investments under the first deduction.

**Partnership Profits:** Partnerships, as such, are not required to file a return of their profits nor to pay a tax thereon. Each member of the firm, however, must make a personal return of his share of profits including undivided profits as well as those actually distributed among the partners and withdrawn from the business, provided his total net income from all sources exceeds \$3,000 for the year. Any firm must, upon request of the Commissioner of Internal Revenue or any district collector, submit a statement of its profits and the names of the individuals entitled thereto.

It is not necessary to show any details of the partnership earnings in the return; only the amount accruing to the person making the return need be shown. It is possible that the form of return may require the maker to state the

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\* See Murray and Carter's "A Guide to Income Tax Practice," 6th ed., p. 268 (London, 1911).

percentage of the total partnership profits to which he is entitled.

It is most important for a person reporting his share of the profits of a partnership first to eliminate therefrom his proportion of any income from tax exempt sources, such as interest on U. S. Government bonds or bonds of a State, municipality, school district, etc., which may be included in the firm's income. Furthermore, he should take credit under the seventh deduction for his proportion of any dividends which the firm may have received on the stock of corporations. Should income tax have been deducted at the source of any income contributing to the firm's profits, he should take credit under the eighth deduction for his proportion of such income on which the tax has already been deducted.

**Real Estate Income:** The full amount of rentals from real estate should be entered under gross income. The various expenses in connection with the real estate should be entered under the deductions indicated by the numeral prefixed to each class of expenses as follows: (1) Repairs, ground rent, commissions on collections and other maintenance and operation expenses (the last named including such expenses as heating, sweeping, elevator service, etc., in the case of buildings where the rental includes service), (2) interest on mortgage, (3) taxes, (4) losses by fire or storm in excess of insurance received therefor, (5) rents which may have been included in gross income, either in the current or previous year, and which have proved uncollectible, and (6) depreciation of buildings and of equipment forming a part of the building, such as elevators, heating or power plant, etc. It is not permissible to include in the deductions any payments for additions to the property, or for renewals or replacements for which depreciation allowances have previously been made, or for local assessments for such benefits as paving, sewers, etc.

A strong reason for including the gross amount of the

rentals, before deducting any expenses whatever therefrom, under gross income is that on all rents exceeding \$3,000 per annum paid to others than corporations the tenant is required to deduct the income tax from his rent payments and pay it over to the Government. The landlord should take credit in his return for the rents on which the tax was deducted by the tenant, and in order that the return may appear regular on its face it is desirable that the gross amount of the rents on which the tax was deducted be shown; otherwise, the income from real estate entered as gross income might appear as less than the amount of rents on which the return states the tax was deducted by the tenant.

**Undivided Interests in Real Estate:** Persons receiving income from an undivided interest in real estate will enter the net amount received under gross income. Ordinarily the normal tax will have been deducted before the interested parties receive their respective shares of the net income, either through deduction by the tenant from the rent paid by him or through deduction by the agents or trustees who collect the rents and distribute the net income among the interested parties. Such persons will need to exercise vigilance to make sure that there is not a duplicate deduction of tax. In the case of a large building, for instance, where there are many tenants some would pay rentals exceeding \$3,000 per annum and would, therefore, deduct the tax from the rent; other tenants would pay less than \$3,000 per annum and therefore not deduct the tax. If the agent fails to exercise the greatest care he may deduct tax on part of the net income distributed to the parties in interest from which the tenants also deducted the tax.

Should the parties in interest handle the property themselves and not through an agent, the tenant paying directly to each party in interest his respective share of the rent, such income would be entered by the recipient in his return in the same manner as any other real estate income.

**Income from Estates:** All persons receiving income from trust estates will need to give careful attention to the questions raised in the preceding paragraphs, as some or all of the estate's income may be from interest on tax exempt bonds or may be from sources where the tax was deducted.

So far as the normal tax is concerned, the return for the beneficiary would be made by the trustees. In the case of persons subject to the super-tax, however, income from a trust estate, excepting that from tax exempt bonds, must be included in the personal return and it is important that credit be taken under the eighth deduction for the amount on which the tax has already been paid.

**Proceeds of Insurance Policies:** The act is very clear on the point that the proceeds of life insurance policies paid on the death of the person insured are not to be treated as income.

The act is not as clear with reference to amounts received by the insured on maturity or surrender of life, endowment or annuity policies. Apparently the intent is that only that part should be excluded from income which represents a return of premiums paid on the policies and that the excess of endowment or surrender values received over premiums paid in should be treated as taxable income. This would also be true of that part of annuity payments received which represents earnings on the investment as distinguished from the partial return of principal.

This view is corroborated to some extent by the following statement made by Representative Hull (who drew the income tax bill introduced in the House) in the course of a speech in the House:

. . . there is no tax . . . upon the proceeds of life insurance policies paid at the death of another. There is no tax imposed on any individual with respect to the return of any sum or amount invested in insurance as a business proposition during his life. Of course, if there should be actual earnings coming back to him along with a return of a portion of the investment, as in the case of an annuity, for instance, then as determined by the expert knowledge of the actuary it would constitute actual earn-



ings such as would arise from the interest on a loan, and the individual would be expected to keep that in mind as a part of his taxable income if the company had not already paid the tax.\*

On the other hand, Mr. Luther F. Speer, formerly head of the Corporation Tax Division and recently appointed Deputy Commissioner of Internal Revenue, states in his pamphlet on the "Federal Income Tax Law," published immediately after the passage of the law, that

Proceeds of life insurance policies, whether paid upon the death of the insured or paid to the insured upon the maturity . . . or . . . surrender of the contract, are free from the tax and should not be included in the return of income.

It may further be pointed out that in no case would a policy holder be subject to normal tax on "dividends." "Dividends" received which do not exceed the amount of premiums paid within the year are clearly but a partial return of the premiums paid. "Dividends" received in excess of premiums paid within the same year, such for instance as those received on paid up policies, have already been taxed as a part of the insurance company's income.

**Allowances:** An allowance received by a person from a parent or other relative would not be subject to income tax in the hands of the recipient. The law specifically states that taxable income includes "the income from but not the value of property acquired by gift, bequest, devise or descent." Such an allowance, unless it be for services rendered, is certainly in the nature of a gift. It is only equitable that such an allowance shall be free of tax as to the recipient thereof since the person paying it has already been taxed on the income out of which the allowance is paid.

**Profits on Real Estate Sales:** The law states that taxable net income includes "gains, profits, and income derived from . . . dealings in property, whether real or personal . . ." Apparently the intent is that profits on sales of real estate are subject to income tax, even though the profits

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\*See "Congressional Record," April 26, 1913.

may have accrued over a period of years and not in any one year. Certainly in the case of a person engaged in the real estate business profits on sales of real estate would be a part of the net income subject to tax.

It is worthy of mention, however, that during the consideration of the income tax bill in Congress, Representative Hull in his replies to questions asked by Representative Mann said:

. . . in construing all these laws that I have observed . . . unless the unearned increment is expressly made income, it is not considered income in any sense of the word, but simply increase of value or capital.

and, what is still more to the point, further said:

My judgment would be that as to an occasional purchase of real estate not by a dealer or one making the buying and selling a business this bill would only apply to profits on sales where the land was purchased and sold during the same year.\*

Mr. Hull having drafted the income tax bill as it was submitted to the House, his statement may be taken as showing the intent of the framers of the bill. Until such time as a contrary ruling is made, a taxpayer would seem to be justified in preparing his return on the basis defined by Mr. Hull.

Should it finally be decided that profits on real estate sales accrued over a period of years must be reported as income, expenditures for additions and improvements between the time of acquiring and time of selling the property should not be overlooked. They should be added to the original cost and the aggregate deducted from the sale price to determine the profit, if any.

A further difficulty would be experienced when real estate is inherited and later sold. Here there would be no cost to the seller which could be used as a basis to determine the profit realized. If the property is sold shortly after being inherited it would be fair to assume that the sale price represented the value of the property when inher-

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\*See "Congressional Record," April 26, 1913.

ited and that no profit had been realized. If the property is held for a period of years before being sold it might be necessary to estimate the value at the time the property came into the possession of the seller to get a basis for determining the profit realized.

**Profits Accrued Prior to March 1, 1913:** The matter of profits realized on real estate and other long time investments held prior to the date as of which the income tax law went into effect, viz., March 1, 1913, is one which merits careful consideration. It may be said at the outset that an apparent profit, due to increase in market value of the investment, need not be reported as income until it is actually realized by the sale or liquidation of the investment.

Furthermore, when a property is finally disposed of, only such part of the profit on the sale as actually accrued after March 1, 1913, should be reported as income. Obviously it would be as improper to tax the profits accrued prior to that date as it would be to insist on the inclusion of ordinary income from salary, interest, etc., earned prior to March 1, 1913, in the return.

Where the fair market value of the property at March 1, 1913, can be established, only the excess of the final realization over such value at March 1, 1913, should be treated as income. When it is not feasible to establish a definite market value as of March 1, 1913—and this will probably be the case with a majority of such investments—the fairest way would be to treat as income that proportion of the profits realized which the period between March 1, 1913, and the date of sale is of the total period for which the investment was held.

**Losses on Investments:** Losses on investments in bonds, mortgages, notes or other obligations due to the bankruptcy of the corporations, firms or individuals who have issued them are to be entered under the fifth deduction. Such investments are “debts due to the taxpayer.”

No specific provision appears in the law for losses sustained by the bankruptcy of corporations in which stock is held or by the sale of stocks, bonds or real estate at a lower price than was originally paid for them, excepting when such losses are sustained by persons who make a business of buying and selling securities or real estate. In the case of such persons the losses could doubtless be taken credit for under the fourth deduction as they are "losses . . . incurred in trade."

As regards other persons than those making a business of dealing in securities and real estate, Mr. Hull, already referred to as the writer of the income tax bill, was asked in the House of Representatives whether a person making a profit on one investment and a loss on another would be permitted to offset the loss against the profit. Mr. Hull is quoted\* as saying in reply that

if he is simply making a casual investment of that kind now and then, or here and there, I think he would report his gains for taxable purposes, and probably would be allowed for his loss. It would not be a trade loss, but set off against the particular gain from the other stock transactions.

This is quite logical and satisfactorily disposes of the matter when there are sufficient profits on some investments to fully offset losses on others. It does not meet the situation, however, where the losses on investments exceed profits, or there may have been no profits realized at all. The question in that case is: May such losses be allowed as a deduction from gross income in determining the taxable net income? A person does not have any real net income until the losses incident to his investments are allowed for. A bank, for instance, may have income from a number of independent sources such as interest on loans, interest on securities owned and rents of real estate, amounting to a considerable sum, yet no one would say that it had really earned any net income until the losses on such securities as became worthless, or were sold

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\* See "Congressional Record," April 26, 1913.

at less than their cost and the losses on real estate sold below cost had been deducted from the gross income. In making its return under that section of the law taxing the net income of corporations, the bank would be allowed to deduct such losses from its gross income. It would surely not be equitable to refuse an individual the deductions which are allowed a corporation.

It can be argued that the deduction allowed for "losses incurred in trade" should be construed broadly, that the spirit of it is to allow credit for all legitimate losses (gambling losses would, of course, not be a proper deduction), that it puts the individual on a par with the corporation, and that the word "trade" is not to be interpreted in a narrow sense. When an individual makes an investment in securities or real estate, even though it be only occasionally or at rare intervals, he is on such occasions engaging in a venture analogous to a "trade" venture.

**Allowances for Depreciation of Property:** The allowances for depreciation of property should not be overlooked. Buildings, machinery and fixtures all have a limited life, be it long or short, and the contents of mines, quarries, oil and gas wells are limited. Even timber lands, where the contents of the lands are still increasing by reason of the natural growth, are soon denuded when lumbering operations once begin. Hence it follows that a claim for the allowance of depreciation of buildings and equipment and for the exhaustion of mineral deposits and standing timber should not be overlooked where the taxpayer owns such property.

**Exhaustion of Mines:** The deduction which will be allowed for the exhaustion of mineral deposits is limited. It must not exceed 5 pct. of the value of the year's output at the mine. This limit will in some cases be found to restrict the exhaustion allowance to less than the actual cost of the minerals to the taxpayer.

For instance, if a tract of coal land costing \$600 per acre

averages, say, 8,000 tons of coal per acre, the cost of the coal in place is  $7\frac{1}{2}$  cents per ton. The land after being mined out might have some value which would reduce the net cost of the coal, but such value is usually comparatively little and for the purposes of the present illustration may be ignored. If the average selling price per ton at the mine during the year was, say, \$1.20, the maximum exhaustion allowance would be 6 cents per ton or only 80 pct. of the actual cost. Consequently the amount on which the owner of the mine would be taxed in this case would be in excess of the true income from the mine.

In very many cases the owner and the operator of a mine are different persons. Where the operator of a mine is a lessee, he would doubtless be permitted to deduct from his gross income the full amount of royalty paid for the coal or other mineral mined, irrespective of what the ratio between the value of the mineral and the royalty paid on it might be. Royalty is admittedly a necessary expense of the business. The owner of the mine would on the other hand enter the full amount of the royalty received as gross income in his return, but would be permitted to deduct only the statutory 5 pct. of the selling value of the mineral for the exhaustion of the mine. If the actual cost of the mineral in place in the ground is less than 5 pct. of the value of the mineral after being mined, the allowance would be for only the actual cost.

In the case of the owner of a mine, the limitation on the exhaustion allowance would not be 5 pct. of the royalty received but of the total value of the mineral after being mined. This is a very important distinction. If, in the illustration of the coal mine just cited, the owner were to receive, say, 10 cents per ton royalty it would make a very vital difference whether the 5 pct. were on 10 cents, making the allowance  $\frac{1}{2}$  cent per ton, or whether it were on \$1.20, making the allowance 6 cents per ton. The latter is the correct basis of calculation.

**Exhaustion of Oil Wells:** If oil wells are construed to come within the limitation prescribed for mines, this 5 pct. allowance must be very carefully handled by lessors of the land on which the wells are located. It is customary in leasing oil lands for the lessor to receive as royalty a fixed part of the oil produced by the wells, one-eighth of the output being a widely used figure. Assuming that the entire production of the wells (over the sale of seven-eighths of which the lessor has no control) is sold at about the same average price at which he sells his royalty oil, 5 pct. of the value of the oil produced would be equal to 40 pct. of the royalties received.

**Additional Allowance for Depreciation of Mining Plants:** The limited allowance for exhaustion of mineral deposits was obviously not intended to include the allowance for the depreciation of the buildings and equipment used in the mining operations or for the development cost which it is customary to spread over the output of the mine. An additional depreciation allowance for such buildings and mining equipment and for the extinguishment of the development cost should be claimed. The same thing would be true of the drilling of wells and the structures and equipment used for pumping oil.

The cost of drilling dry holes (i. e. if oil is not struck) should be taken credit for as expenses of operation and not as a depreciation allowance.

**Corporation Dividends and Income on which Tax was Deducted at Source:** The seventh and eighth deductions need form part of a personal\* return only if the maker's total net income exceeds \$20,000 for the year, in which event every item of income must be included in the return. If the person's total net income from all sources is not more than \$20,000, and hence not subject to the super-tax, corporation dividends and income on which the tax was

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\* A personal return is one made by the recipient of the income himself as distinguished from a return made for him by another person, or a firm or corporation which has deducted the tax from income paid to him.

deducted at the source need not be included in the return. In that event such dividends and income already taxed would also be omitted from the seventh and eighth deductions.

### Rate of Tax

The normal tax rate is 1 pct. on the entire amount of net income computed as previously described.

In the case of incomes which exceed \$20,000 for the year an additional tax—called in economic phraseology the “super-tax”—will be levied as follows:

Pct.	on the amount exceeding	and not over
1	\$20,000	\$50,000
2	50,000	75,000
3	75,000	100,000
4	100,000	250,000
5	250,000	500,000
6	500,000	

This additional tax does not mean, for instance, that the person with an income of \$100,000 subject to no exemption other than the \$3,000 to which all persons are entitled, must pay a total tax of 4 pct. on the \$97,000, or \$3,880. An income of \$100,000 would be subject to a tax of

1 pct.	on	\$97,000	\$970.00
1 pct.	additional on	30,000	300.00
2 pct.	additional on	25,000	500.00
and 3 pct.	additional on	25,000	750.00
or a total tax on \$97,000 of			<u>\$2,520.00</u>

The situation as to the additional tax is somewhat complicated by the fact that the tax to be withheld at the source of various classes of income, as referred to later on, is to be withheld at the uniform rate of 1 pct. The tax on the net income of corporations is also to be 1 pct. regardless of the amount of such income. This does not mean, however, that persons with an income exceeding \$20,000 will escape the additional tax on such part of their income



on which the tax has been withheld at the sources of the income, or which is represented by corporation dividends and is, therefore, exempt from the normal tax.

Persons with an annual income exceeding \$20,000 must make a personal return showing all income received, even though tax has been withheld from part or all of it at its source. The total tax payable will then be based on this return, due allowance being made for such part of the normal tax as is shown by the return to have been deducted at the source or sources of the income and for the normal rate of tax on such part of the income as was derived from corporation dividends.

For the purpose of assessing the additional tax, there will be included as taxable income that part of the undivided profits of a corporation to which the person making the return would be entitled if the profits were divided, provided that in the opinion of the Secretary of the Treasury the corporation was formed or is being fraudulently availed of to prevent the imposition of the additional tax by permitting the profits to accumulate as surplus beyond the reasonable needs of the business instead of being distributed among the stockholders. On request of the Commissioner of Internal Revenue or any district collector such corporation must forward a statement of such profits and the names of the individuals entitled thereto if they were distributed.

The maker of a return is justified in assuming that no corporation in which he has stock is being used to evade tax. The question is obviously one to be raised by the Commissioner of Internal Revenue and not by the taxpayer.

### **Time of Payment**

Notice of the amount of tax assessed is to be given the persons affected on or before June 1st. The tax must be paid not later than June 30th.

### **Penalty for Delinquent Tax**

Taxes remaining unpaid after June 30th and after ten days from notice and demand thereof by collector, will be increased by 5 pct. of the amount unpaid and interest at 1 pct. per month from due date. This penalty will not be exacted from the estates of insane, deceased or insolvent persons, presumably because of the delay frequently caused by court proceedings and liquidation in such cases.

### **Deduction of Tax at Source of Income**

The framers of the law have followed to a certain extent the British precedent of deducting the tax at the source of the income wherever feasible. This is accomplished by requiring that on and after November 1, 1913, all persons or firms, corporations and associations, whether acting for themselves or on behalf of some one else, shall deduct the normal tax of 1 pct. from payments of

interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual gains, profits, and income of another person exceeding \$3,000 for any taxable year;

and pay such tax over to the Government.

The tax is to be deducted and paid over to the Government from all payments of interest on bonds and mortgages, or deeds of trust, or other similar obligations of corporations, whether payable annually or at shorter or longer periods, irrespective of whether or not such interest payments amount to \$3,000.

The tax must also be deducted from all collections of interest and dividends (irrespective of amount) on foreign bonds and stocks not payable in the United States.

Certain exceptions to the foregoing requirements that tax be deducted at the sources of income are hereinafter described under the captions of

Tax Not to be Deducted from Dividends, page 32.

Tax Not to be Deducted from Payments to Corporations, page 32.

Exemption from or Abatement of Tax Deductible at Source, page 33, and

"Tax Free" Bonds, page 35.

In no case is the super-tax to be deducted at the source of the income. Only the normal tax of 1 pct is to be so deducted.

The details of the procedure to be followed in deducting the tax at the source of the income are not fully covered in the law. Much was left to be dealt with in regulations to be prescribed by the Commissioner of Internal Revenue. The regulations thus far published may be summarized as follows:

**Deduction of Tax from Interest on Bonds and Mortgages, or other similar obligations (including equipment trust agreements and receivers' certificates) of Corporations**

**When Tax Shall be Withheld by Debtor:** Excepting when the recipient of the interest is a corporation, or is an individual claiming the \$3,000 or \$4,000 exemption (as described under Exemption from or Abatement of Tax Deductible at Source), the debtor corporation or its fiscal agent shall deduct the tax, provided that the coupons or orders for registered interest are accompanied by certificates of ownership signed by the owners of the bonds.

**NOTE.** From the Government's standpoint, tax would not be withheld in the above cases by any banker other than the one acting for the corporation in paying its interest. As a matter of fact, however, a bank which credited a depositor's account for coupons at the time they were deposited would necessarily have to credit the coupons at their face value less the tax, if the certificate accompanying the coupons indicates that the tax will be deducted from payment of the coupons. Similarly, when coupons are taken only for collection the proceeds, when finally paid over by the first bank handling the coupons, will be net of any tax which the debtor corporation must deduct.

**Certificates of Ownership and Exemption:** Four forms of ownership certificates are provided in the regulations, viz.:

1. Certificate for a citizen or resident of the United States.
2. Certificate for corporations or other organizations which are either taxable or exempt from taxation under the corporation section of the income tax law (tax is not to be deducted from payments to such corporations or organizations).
3. Certificate for partnerships (tax is to be deducted from payments to partnerships in the same manner as from those to individuals).
4. Certificate for non-resident alien not subject to tax as hereinafter explained.

The certificates (the forms of which will be found in the Appendix numbered Forms 1000, 1001, 1003 and 1004, respectively) provide for showing the description of bonds declared to be owned and the amount and due date of coupons or registered interest matured. The certificates do not have to be under oath.

The form of certificate for individuals also provides for claiming the \$3,000 or \$4,000 exemption when this is in order.

The form for partnerships may be signed by one partner only, but must show the names and addresses of all the partners.

The person or corporation first receiving coupons for collection shall write or stamp his or its name and address and date on the back of accompanying certificates.

**When Tax Shall be Withheld by First Collecting Agency:** When coupons are not accompanied by the ownership certificates above referred to, the first bank, trust company, banking firm, individual or collecting agency receiving the coupons for collection, or otherwise, shall withhold the tax and attach to the coupons a certificate (see Form 1002 in the Appendix) showing the party by whom tax deducted, party from whom coupons received, bonds from which coupons were taken and amount of interest. The payor of the interest will then not deduct the tax but will pay the interest in full and will deliver to the Government

in lieu of tax the certificates of the banks or other agencies which have deducted the tax.

**Interest due before March 1, 1913:** Tax shall not be withheld on coupons or registered interest due prior to March 1, 1913, although paid at a later date.

**Bond Interest Paid Non-Resident Foreigners Exempt:** The tax will not be deducted from interest on bonds, mortgages, equipment trusts, receivers' certificates, or similar obligations of which the bona fide owners are citizens of foreign countries and residing abroad. The non-resident alien form of ownership certificate (see Form 1004 in the Appendix) must accompany the coupons or interest orders or normal tax will be deducted. The certificate may be signed either by the owner himself or on behalf of the owner by a reputable bank or bankers, or other responsible collecting agency, certifying to the ownership of the bonds and giving the name and address of the bona fide non-resident alien owners.

**Temporary Certificates:** Coupons presented to a debtor between November 1st and 16th, 1913, did not have to be accompanied by certificates in any of the forms hereinbefore described, provided such coupons were accompanied by a certificate (Form 1005 shown in Appendix) stating that the coupons, of which a description must be given, came into the possession of the bank or person presenting them unaccompanied by an ownership certificate and giving the name and address of the owner of the bonds or, if this is not known, so stating.

On presentation to the debtor on or before February 1, 1914, of a proper certificate of ownership (which takes the place of the temporary certificate), the debtor may return any tax previously withheld to which ownership certificate shows bondholder to be entitled. Any temporary certificates for which certificates of ownership are not substituted as above are to be delivered to the Collector of Internal Revenue by March 1, 1914.

**Designation of Fiscal Agents:** The debtor corporation may appoint fiscal agents to act for it in matters appertaining to collection of tax. Notice of the appointment must be filed with district Collector of Internal Revenue.

**Disposition of Certificates:** The debtor or its fiscal agents shall deliver all certificates (both ownership and deduction) with list of names and addresses of those for whom tax has been withheld and the amounts thereof to the district collector of internal revenue by the 20th of the month succeeding that in which the certificates were received.

**License Required for Collection of Foreign Income:** All persons, firms and corporations undertaking for accommodation or profit the collection of foreign payments of interest and dividends by means of coupons, checks or bills of exchange are required to procure a license from the Commissioner of Internal Revenue and to give bond in amount and under conditions prescribed by the Commissioner. Further, they will be subject to such regulations, prescribed by the Commissioner with the approval of the Secretary of the Treasury, as will enable the Government to verify the withholding and paying over of the tax.

Any person knowingly undertaking the collection of such foreign payments without a license, or without complying with the prescribed regulations, will be guilty of a misdemeanor and subject to a fine not exceeding \$5,000, or imprisonment not exceeding one year, or both.

**By Whom Tax is Withheld:** The licensed person, firm or corporation first receiving any foreign items for collection or otherwise, shall withhold therefrom the normal tax of 1 pct. He (the licensee) shall thereupon indorse thereon (or on an accompanying statement identifying the item on which the tax has been withheld) the words "Income tax withheld by (giving his or their name and address and date)." This indorsement will relieve subsequent holders or purchasers from the duty of withholding the tax.

**Record and Report by Licensees:** All persons licensed

shall keep records showing from whom every item has been received. These records shall be open to inspection by internal revenue officers.

A list of the names and addresses of persons from whom such items have been received, the amounts of tax deducted and the sources thereof, must be filed with the district collector of internal revenue by the 20th of the month following the receipt of the items.

**Exemptions on Foreign Items:** Individuals claiming the \$3,000 or \$4,000 exemption and corporations may secure exemption (partial or complete, as the case may be) from deduction of the tax on foreign items owned by them by executing the same forms of certificates of ownership as are used for coupons payable in the United States. In such cases the licensee first receiving such items shall retain the certificates and deliver them with the above mentioned monthly lists to the district collector of internal revenue. The licensee shall also attach to the items (identifying them) or indorse thereon the words "Income tax exemption claimed through (giving name and address of licensee)." This will relieve subsequent holders from the duty of withholding the tax thereon.

The regulations for collection of the tax on foreign obligations apply to the interest on all foreign bonds, even if the coupons may be at the option of the holder payable in the United States as well as in some foreign country.

### **Deduction of Tax from Income from Sources Other than Interest on Corporate Obligations**

**Who Shall Deduct Tax:** All persons, firms, corporations and associations, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, agents, receivers, conservators and employers having the control, receipt, custody, disposal or payment of fixed or determinable annual profits or income of another person

exceeding \$3,000 for any year must deduct the normal tax from such payments.

If the income is not fixed or certain and payable at stated periods, or is indefinite or irregular as to amount or time of accrual, there is no obligation on the payors to deduct tax therefrom at source.

**When Tax Shall be Deducted:** A "withholding agent" (the name given by the regulations to all on whom there is an obligation to deduct tax from payments) who pays monthly, or at other periodical intervals during the year, interest (other than on corporate obligations), rents, salaries, wages, etc., shall not withhold the tax until the aggregate of the payments during the current year exceeds \$3,000. The tax shall then be withheld on the whole \$3,000 and excess thereof, unless the person to whom the income is due files with the withholding agent a claim for the \$3,000 or \$4,000 exemption. In the latter case the tax is to be deducted only on the payments in excess of the exemption claimed.

**On What Amount Tax Shall be Deducted:** The law requires that the tax be deducted from all payments of the designated classes "exceeding \$3,000 for any taxable year." Many persons have erroneously understood this as meaning that the tax is to be deducted only on the excess over \$3,000. Unless a claim for the \$3,000 or \$4,000 exemption is filed with the payor, the tax must be deducted on the entire amount of the payment or payments.

**Tax to be Deducted Only Once:** After the tax has once been withheld, other parties through whose hands the income may subsequently pass are not to deduct tax again. It is intended that the debtor or his, her or its duly appointed agent shall deduct the tax.

**Certificate for Deduction by Others than Debtor:** Apparently, however, it is recognized that there will be times when the tax will be deducted by some one other than the debtor, as the regulations provide a form of certificate (see



Appendix, Form 1006) to be filed with the collector of internal revenue by anyone other than the debtor who has deducted tax at the source of income.

**Tax to be Deducted After October 31, 1913:** The income tax law was finally enacted on October 3, 1913. It took effect as of March 1, 1913, so far as the date from which income is taxable is concerned. The provision requiring the deduction of tax at source of income did not take effect, however, until November 1, 1913.

During November and December, 1913, tax is to be deducted at the source only on payments exceeding \$3,000 within the two months. On and after January 1, 1914, the tax is to be deducted from payments exceeding \$3,000 in the year.

#### **Tax Not to be Deducted from Dividends**

It should be especially noted that dividends on the capital stock of corporations (except foreign corporations not doing business in the United States) are not included in the payments from which the tax is to be deducted by the payors.

The entire net income of business corporations is subject to a tax of 1 pct. which must be paid by the corporations irrespective of whether or not such net income is paid out to the stockholders as dividends or permitted to accumulate as surplus or undivided profits of the corporation. Therefore, the normal tax on dividends to stockholders has already been paid by each corporation as a part of the tax on its entire net income and a deduction of tax from dividends and payment thereof to the Government would be a duplication.

#### **Tax Not to be Deducted from Payments to Corporations**

Another matter to be especially noted is that the tax is not to be withheld from any payments to a corporation. The law specifically states that "the provisions . . . relat-

ing to the deduction and payment of the tax at the source of income shall only apply to the normal tax . . . imposed on individuals." For example, the payor of interest to a bank or of rent to a company owning real estate need not withhold the tax. In the case of similar payments to individuals, however, the payor must, if the payments exceed \$3,000 for the year, deduct the tax.

The reason for waiving the deduction of tax from payments to corporations is, doubtless, that all corporations are required to file a complete return of all their income and the revenue authorities can verify the return by examination of the corporation's books.

The regulations prescribed for the deduction of tax on corporate interest payments indicate that in the opinion of the Commissioner of Internal Revenue the tax is to be withheld on income payments to partnerships, in other words that partnerships are in the same category as individuals.

### **Personal Liability for Deductible Tax**

Of especial importance is that provision of the law making all persons or corporations who should withhold and pay over to the Government the income tax on the classes of payments referred to personally liable therefor. A failure to deduct the tax from payments falling within the classes mentioned means that the person or corporation responsible for the failure will be mulcted for the amount of the tax which should have been deducted.

### **Exemption from or Abatement of Tax Deductible at Source**

A person whose income is subject to deduction of tax at its source but who wishes to secure the benefit of the \$3,000 exemption (\$4,000 in the case of a married man whose wife is living with him or vice versa) must either file with the person required to withhold the tax, a signed notice claiming the benefit of such exemption and there-

upon no tax will be withheld on the amount of the exemption,

or,

make application (presumably to the Commissioner of Internal Revenue) for a refund of the tax on the amount of the exemption.

The form of exemption notice to be given the person required to withhold the tax will be found in the Appendix (Form 1007).

A false statement or fraudulent representation in a claim for exemption renders the maker liable to a fine of \$300.

To secure the benefit of the deductions provided for in the computation of net income, a person whose income is taxable at its source must either

file with the person required to withhold the tax, not less than thirty days prior to March 1st, a return or statement of his annual profits and income from all other sources and also the deductions asked for,\* this statement becoming part of the return to be made in his behalf by the person required to withhold the tax,

or,

similarly make application for deductions to the collector of the district in which return is made or to be made for him of income on which the tax has been withheld.

Neither the law nor the regulations specifically state whether or not in the event of the recipient of the income filing the required statement with the person or corporation otherwise required to withhold the tax, the deduction of the tax so far as it relates to the amount of deductions claimed will be waived; or whether the tax will be withheld, but refunded by the person or corporation withholding it upon approval by the Collector or the Commissioner of Internal Revenue of the statement above mentioned.

It is quite probable that the latter course is intended; otherwise the law would probably state, as it does in the

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\* See Form 1008 in the Appendix.

case of the \$3,000 exemption, that the tax is not to be withheld if the required statement be filed with the person who is obligated to deduct the tax. Another reason for the different course with reference to the tax on the amount of the deductions is that the propriety of the deductions will sometimes require a revenue office ruling, whereas in the case of the \$3,000 exemption a misconstruction of the provision therefor is hardly possible.

If the recipient prefers to make the application for deductions to the collector rather than to the person or corporation required to deduct the tax, such application must also be filed not less than thirty days prior to March 1st.

The person required to withhold the tax may make the statement and the application for deductions for a minor, insane person, one absent from the United States or a person incapacitated by illness, provided he has sufficient knowledge of his beneficiary's affairs to make a complete return and does so under oath. See Form 1009 in the Appendix for the form of the affidavit to be made in such cases.

### **"Tax Free" Bonds**

In many corporation bonds there is a provision that the interest is payable without deduction of any taxes, national, state or municipal. If the obligation of the bond is to be carried out as agreed, the corporation which issued the bond must pay the full amount of the interest without deduction, yet on the other hand the Government demands under the new law that the amount of income tax be deducted from the interest on corporate obligations and paid over to the revenue collector.

Unless legitimate contracts in effect at the time the law was passed were intended to be invalidated by its enactment, it would appear that the corporations which have issued such "tax free" bonds will have to pay to the holders thereof the interest without deduction of income tax and

pay to the Government the tax which would have been deducted from the interest payments had the bonds not contained the tax free provision. The tax will, therefore, reduce the net earnings of the corporations and will really be paid by the stockholders instead of by the bondholders. However, the same effect would inevitably follow the imposition of any tax, no matter by what name called, on such bonds, and the intent of a tax free clause in a corporation bond is that the burden of any tax imposed shall fall on the corporation, i. e. the stockholders, and not on the bondholders. Any corporation attempting to evade the assumption of normal income tax on the interest paid on its tax free bonds would be in the position of repudiating its obligations to its bondholders and would find it difficult to make further bond issues.

As to the future, the income tax law provides that a tax free provision in any obligation issued after the passage of the law shall be invalid so far as regards the waiving of the deduction of Federal income tax from the interest payments.

All holders of bonds issued prior to the passage of the income tax law should examine them carefully to see whether or not they contain a provision for the payment of interest free of all taxes, more particularly national taxes. In such cases the holders of the bonds would be entitled to receive interest on the bonds without deduction of income tax and yet at the same time be entitled, in making the annual return of income, to claim credit under the eighth deduction provided for in the law, viz., "the amount of income, the tax on which has been paid or withheld for payment at the source of the income."

The exact wording of the tax free clause must be scrutinized to ascertain the extent of the bondholder's rights. Some bonds will be found to specify freedom from state and municipal taxes, no mention being made of Federal taxes; in such cases the corporation which issued them

will be under no obligation to waive deduction of the Federal income tax.

The question has been raised whether or not corporations could also be compelled to pay the super-tax on the interest paid on tax free bonds. The usual forms of tax free clause provide that the interest shall be paid without deduction of any tax which the corporation may be permitted or directed by law to deduct or retain. Under such a clause the corporation need reimburse the bondholder, or assume his income tax, only to the extent to which it is required to deduct it from the interest payment, viz., 1 pct. thereof. The super-tax in the case of persons whose total net income exceeds \$20,000 per annum must be borne by the bondholder. It is very unlikely that any corporation, unless it has issued bonds worded in an unusual manner, can be compelled to pay the super-tax for any of its bondholders.

#### **Return to be Made; When and by Whom**

On or before March 1st of each year, every person residing in the United States, whether or not a citizen, and every citizen residing abroad, who has received net income exceeding \$3,000 during the preceding calendar year, must file a return made under oath or affirmation with the collector of internal revenue for the district in which he resides or has his principal place of business. The only exception is in the case of persons whose total net income does not exceed \$20,000 and is all derived from corporation dividends or from sources where the tax is deducted before the income is paid over to the recipient.

Every foreigner residing abroad who has received net income in excess of \$3,000 from property owned or business, trade or profession carried on in the United States must likewise make a return of the income so received. A taxpayer residing abroad must make the return to the collector of the district in which his principal business is carried on in the United States.

Guardians, trustees, executors, administrators, agents, receivers, conservators and all persons or corporations acting in any fiduciary capacity must file a return of net income of the person for whom they act. A return by one of two or more joint guardians, trustees, etc., is sufficient.

For the year 1913 the return is to cover only the net income accruing from March 1st to December 31st, inclusive, after deducting five-sixths of the specific exemptions and deductions already referred to.

### **Return for Tax Deducted at Source**

For all tax deducted from payments of salaries, interest, rent, etc., the persons, firms, corporations or associations making the deductions must, in addition to paying the tax over to the Government, make returns showing the portion of income of each person from which normal tax has been withheld. The name and address of each person must be given; if either the name (as in the case of coupons) or the address is unknown, that fact must be stated. This return is regarded as being made for the person from whose income the tax has been deducted at its source. Should such person have no other income, excepting corporation dividends, on which the tax has not been deducted at its source, and provided his total annual income from all sources does not exceed \$20,000, he need not file a personal return.

As only the normal tax is to be deducted at income sources, regardless of the amount of income, every person with an annual income exceeding \$20,000 must make a personal return, even though the normal tax has been deducted at the source of every dollar of the income. All additional or super-tax will be assessed on the basis of personal returns. In the case of such returns the Government by reason of the returns made for normal tax deducted at the sources of income will be in possession of information to

enable it to verify to at least some extent the personal returns.

The returns for tax deducted at the sources of the income must be made at the same time as personal returns, i. e., not later than March 1st of the year following that for which they are made. According to the regulations concerning tax deductions from payments of corporate interest, returns will have to be made by the 20th of each month for the tax deducted from such payments during the preceding month.

The return made by a person, firm, corporation or association of tax deducted from payments of salaries, rents, interest, etc., takes the same course as personal returns. It is filed with the collector of internal revenue in the district where the maker has his residence or principal place of business. The tax is then assessed by the Commissioner of Internal Revenue. If there has been no "slip" at any point, the assessment will agree with the amount of tax deducted.

A careful reading of the law does not disclose any requirement that the tax deducted need be paid over to the Government before June 30th of the year following that in which it was deducted, this being the last day for the payment of tax assessed on personal returns.

### **Neglect or Refusal to Make Return**

Neglect or refusal to make the required return, either personal or for tax deducted from payments to another person, renders the person responsible therefor liable to a penalty of not less than \$20 nor more than \$1,000. In addition the tax will be increased 50 pct. after it has been assessed as stated below.

Especially is it to be noted that failure to receive blanks on which to make the necessary returns does not absolve or excuse a person with taxable income from making a return thereof. It is the duty of every such person to see



that he gets the necessary blanks. They may be obtained from any internal revenue collector.

At any time within three years after the return was due the Commissioner of Internal Revenue will, upon discovery of an omission to make return, himself make a return based upon the best information which he can obtain and will then assess the tax. Collectors of internal revenue are empowered to summon persons for examination and to require the production of books and records for the purpose of ascertaining the information needed to make a return when a person has refused or neglected to do so.

In cases of sickness or absence the collector of internal revenue for the district in which the return is to be filed may allow an extension of 30 days from March 1st in which to make the return. Application for the extension should, whenever possible, be made prior to March 1st or at least prior to March 31st.

### **False and Incorrect Returns**

A false or fraudulent return made with intent to evade income tax renders the maker of it liable to a fine not exceeding \$2,000 or imprisonment not exceeding one year, or both, with the costs of prosecution. In addition, the tax as assessed by the Commissioner of Internal Revenue after amending the return, which the Commissioner is empowered to do on discovery of the fraud within three years after the return is due, will be increased 100 pct.

The law does not make specific mention of incorrect returns made in good faith, further than that if the revenue collector believes the income reported to be understated he may, upon notice to the maker of the return to show cause to the contrary, and on proof of the amount understated, increase the return accordingly. Presumably where the maker of the return could show that the inaccuracy was due to an error made in good faith the penalty for false returns would not apply. The maker of a return which is

increased by the district collector may appeal to the Commissioner of Internal Revenue at Washington, submitting all the papers in the case and, if desired, the sworn testimony of witnesses to prove relevant facts.

**Summary of Obligations of Individual with Income of  
Less than \$3,000**

A person with a net income amounting to less than \$3,000 is not required to file a personal return.

Such a person receiving income from sources at which the tax is required to be withheld should file the necessary claim for the \$3,000 or \$4,000 exemption with the person or corporation otherwise required to deduct the tax from the income payment (see page 33). If any of the income consists of bond interest, the necessary ownership and exemption certificates must accompany the coupons deposited for collection (see page 26 and also page 35). Unless the exemption is claimed in the manner indicated, it will be necessary to file a claim for refund of tax deducted at source with a collector of internal revenue.

Any person whose own income is less than \$3,000 for the year, but who pays salaries, rent, interest or similar fixed or determinable annual income or profits to any other persons or firms exceeding \$3,000 in the case of any one recipient must, subject to a claim by the recipient for his \$3,000 or \$4,000 exemption, withhold the normal tax of 1 pct. from such payments (see pages 31 and 32). A return of tax so withheld must be made and the tax be paid over to the Government (see page 38).

## **OBLIGATIONS IMPOSED ON CORPORATIONS**

As in the case of individuals, business corporations must

1. Make an annual return of income.
2. Pay a tax on the taxable net income shown to have been earned.
3. Withhold the normal income tax on certain kinds of payments and pay it over to the Government.

The law contains numerous provisions applying to corporations, however, which require consideration independent of the obligations imposed on individuals.

In its requirements for the making of an annual return of income and the payment of a tax of 1 pct. on the net income, the new law is very similar to the Corporation Tax Law with which most corporation officials are now more or less familiar. There are, however, at least two decided modifications which are worthy of notice.

### **Important Modifications of Corporation Tax Law**

One very important change is that every corporation whose fiscal year does not coincide with the calendar year will now be permitted to make a return for its fiscal year. The requirement of the old law that all returns must be made for the calendar year imposed a hardship on many corporations which, because of conditions inherent in their businesses, could not close their accounts at December 31st. It is very gratifying that the campaign waged by the American Association of Public Accountants for this very desirable modification has been successful.

Another important change, to small corporations especially, is that the former specific deduction of \$5,000 from the net income of each corporation will no longer be allowed. Many small corporations (and large ones whose operations are not very profitable) which formerly escaped

the corporation tax, because their net profits did not exceed \$5,000 per annum, will now have to pay. There are also several important modifications in the manner of computing the taxable net income which are mentioned later under the captions of "Exemptions" and "Basis of Deductions from Gross Income."

### **Taxable Corporations**

Every corporation, joint-stock company or association and every insurance company organized in the United States (not including partnerships) excepting only the classes of corporations or associations mentioned in the following paragraph, must pay a tax of 1 pct. on its net income computed as hereinafter described. Corporations organized or existing under the laws of any foreign country must also pay a tax of 1 pct. on the amount of net income accruing from business transacted and capital invested in the United States.

### **Exempted Corporations**

The law specifically exempts the following corporations and associations from the payment of income tax:

- Labor, agricultural, or horticultural organizations;
- Mutual savings banks not having capital stock;
- Fraternal beneficiary societies, orders or associations operating under the lodge system and providing for payment of life, sick, accident and other benefits to members or their dependents;
- Domestic building and loan associations;
- Cemetery companies organized and operated exclusively for mutual benefit of members;
- Corporations or associations organized and operated exclusively for religious, charitable, scientific or educational purposes, no part of the net income of which inures to benefit of any private stockholder or individual;
- Business leagues, chambers of commerce or boards of trade not organized for profit or no part of the income of which inures to the benefit of the private stockholder or individual;

Civic leagues and organizations not organized for profit but operated exclusively for promotion of social welfare.

It should be especially noted that in the case of the sixth and seventh classes of corporations above mentioned the exemption is forfeited if their stockholders or members receive a financial profit from the operations of the corporation or association.

### **Return to be Made for either Calendar or Fiscal Year**

Every corporation which does not give notice that its fiscal year ends at a date other than December 31st must file a return of its capital stock and indebtedness at that date and its income for the calendar year on or before March 1st of the following year.

Any corporation whose fiscal year does not coincide with the calendar year will be permitted to file its annual return for its fiscal year instead of for the calendar year, by notifying the collector of the district in which its principal office is located of the date with which its fiscal year closes. Its return must then be filed within sixty days after the close of its fiscal year.

The date designated as the close of the fiscal year must be the last day of a month and notice of its selection must be filed with the collector not less than thirty days prior to "the date upon which its annual return shall be filed."

On November 18th, 1913, the Commissioner of Internal Revenue issued a ruling to the effect that the required notice must be in writing, and be filed with the local collector within thirty days after the closing of the fiscal year, which of course is at least thirty days prior to the date upon which its annual return shall be filed.

### **Contents of Return**

The return is to be in form prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury and show

1. Total amount of paid-up capital stock outstanding (or if it has no capital stock, its capital employed in business) at the close of the year.

2. Total amount of bonded and other indebtedness at the close of the year.

3. Gross income, authorized deductions for expenses, losses, interest and taxes, and taxable net income computed as described herein under the caption of "How Net Income is to be Computed."

The return must be made under oath or affirmation of president, vice-president or other principal officer, and treasurer or assistant treasurer.

### **How Net Income is to be Computed**

Net income is to be ascertained by deducting from the gross amount of the income of the corporation received (accrued) within the year from all sources,

1. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property.

2. All losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any;

And, in the case of mines, a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 pct. of the gross value at the mine of the output for the year for which the computation is made;

And, in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts.

Mutual fire insurance companies are not required to report premium deposits returned to policyholders as income but shall report as taxable income all income received from other sources plus such portions of premium deposits as are retained for purposes other than payment of losses, expenses and reinsurance reserves.

Mutual marine insurance companies shall include in

gross income gross premiums received less amounts paid for insurance, but may include in deductions from gross income refunds to policyholders on account of premiums previously received and interest paid on such refunds between ascertainment and payment thereof.

Life insurance companies shall not include as income such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to him or treated as an abatement of premium within the year.

Assessment insurance companies may treat as payments to reserve funds the deposits made with State or Territorial officers, pursuant to law, as additions to guarantee or reserve funds.

3. Interest accrued and paid within the year on bonded or other indebtedness to an amount not exceeding one-half of the sum of corporation's interest bearing indebtedness and paid-up capital stock outstanding at the close of the year;

Or, if corporation has no capital stock, interest on indebtedness not exceeding the capital employed in the business at the close of the year.

In case of indebtedness wholly secured by collateral the subject of sale in ordinary business of such corporation, the total interest paid within the year on any such indebtedness may be deducted as a part of its expense of doing business.

In case of bonds or other indebtedness issued with a guaranty that interest payable thereon shall be free from taxation, no deduction for payment of Federal income tax will be allowed.

In case of a bank, loan or trust company, all interest paid within the year on deposits or on moneys received for investment and secured by interest bearing certificates of indebtedness will be allowed as a deduction.

4. Taxes imposed under authority of the United States, any State or Territory, or any foreign Government and paid within the year.

#### **Net Income of Foreign Corporations**

In the case of foreign corporations net income is to be ascertained in the same manner as described above for domestic corporations excepting that

Gross income shall be only that accrued from business transacted and capital invested within the United States, and the deductions allowed shall be only

Expenses paid and losses sustained in connection with business conducted and properties within the United States,

Interest on indebtedness not exceeding the proportion of one-half of sum of corporation's interest bearing indebtedness and paid-up capital stock outstanding at close of year (or if no capital stock, the capital employed in the business at close of the year) which the gross income from business transacted and capital invested within the United States bears to gross income from all sources within and without the United States, and

Taxes imposed by United States or any State or Territory thereof or the District of Columbia.

### **Exemptions**

The corporation tax was an excise tax and not an income tax. The corporation's net income was used merely as a measure to determine the amount of tax which the corporation should pay for the privilege of doing business under the corporate form. Consequently the net income reported had to include income which by law is exempt from Federal taxation.

The new law, which practically continues the corporation tax, is admittedly an income tax. It follows that corporations will not have to pay a tax on so much of their income as is received from interest on bonds or other obligations of the United States or its possessions, of a State or any political subdivision thereof. Income from these sources should not be included in either the gross or net income appearing in the corporation's annual return.

The \$5,000 exemption which all corporations received under the corporation tax law has been abolished under the new law.

No tax is to be levied on income from the operation of a public utility whenever such tax would impose a loss or



burden on a State, Territory, or District of Columbia, or political subdivision of State or Territory, which may have contracted with a person or corporation for acquisition, construction or operation of such public utility. This provision is not, however, to exempt from tax that part of the income to which such person or corporation may be entitled under such a contract.

### **Basis of Deductions from Gross Income**

That part of the new law defining the manner in which the taxable net income of corporations is to be calculated repeats to a very considerable extent the language of the corporation tax law. It is to be regretted that the framers of the new law did not see fit to abandon the admittedly defective phraseology of the old law and define in a manner consonant with efficient business practice the basis on which corporate net income should be determined.

Unfortunately, the use of the word "received" for gross income and "paid" with reference to deductions is continued in that part of the law relating to the ascertainment of net income. However, the Treasury Department regulations will undoubtedly provide that these words may be understood in a broader sense as meaning "earned" as to gross income\* and "incurred" as to expenses.

It may be pointed out, however, as was done in an earlier paragraph regarding unincorporated businesses, that corporations which find it to their advantage to prepare their statements on a cash basis may be sustained by the courts in doing so. As a precedent may be cited the case of *Mutual Benefit Life Ins. Co. vs. Herold* (198 Fed. 199). This question was one of those at issue in the case quoted

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\* An inconsistency in the text of the law may be pointed out in paragraph G (b) which speaks of gross income "received" by domestic corporations and of the gross income of foreign corporations "accrued." In paragraph G (c) the gross income of both domestic and foreign corporations is referred to as "received."

and was decided in favor of the insurance company. It insisted on stating its premium income on the basis of premiums actually collected as against premiums earned, for which latter the revenue collector contended.

The following important modifications in the deductions from gross income appear in the new law:

**The allowance for exhaustion of ores and other natural deposits** must not exceed 5 pct. of the gross value at the mine of the year's output. This has already been considered in connection with personal returns in an earlier paragraph. The same questions are involved in the case of a corporation as in the case of an individual.

**Mutual fire and marine insurance companies** will not be compelled to include refunds of premium deposits to policyholders in their taxable income. This affects especially the "factory mutuals" which pay to their policy holders "dividends" (erroneously so called) running in some instances from 90 to 95 pct. of the premium received. The corporation tax law, strictly construed, did not allow these "dividends," which were merely refunds of premium deposits, to be treated as deductions from gross income.

**Mutual life insurance companies** will be permitted to exclude from income the "dividends" (also erroneously so called) paid or credited to policyholders which represent a return of premiums received within the year. Apparently "dividends" on paid-up policies, for instance, on which premiums are no longer being received would not be permitted to be applied in reduction of gross income or stated as one of the allowable deductions from gross income.

This modification is a decided improvement over the corporation tax law, which did not permit the deduction of any "dividends" to policyholders. Even so, however, the proper basis for taxation of mutual life insurance companies has not been attained. The proper amount on which to tax mutual life insurance companies would be the

excess of interest, rents and other income not coming from policyholders over all expenses other than payments to policyholders or their beneficiaries. The payments to policyholders would include death claims, annuities, endowments, surrender values and "dividends." That part of these payments which is made from premiums received is merely a return of capital and not income. Only the income derived from the investment of premiums between the time they are received from the policyholders and the time they are returned to them or their beneficiaries (in one of the forms above stated), less the expenses of conducting the business, represents real "income" derived from the amounts placed in the Company's hands by the policyholders for insurance purposes.

**Interest paid** will be allowed as a deduction from income on an amount of indebtedness not exceeding one-half the sum of the corporation's interest bearing indebtedness and its paid-up capital stock at the end of the year. Interest bearing indebtedness would include not only bonds and mortgages, but also notes, accounts and any other obligation on which interest is paid; it would not include ordinary accounts payable on which interest does not run.

By comparison with the interest deduction allowed by the corporation tax law the new law is more favorable to corporations. Corporations whose interest bearing indebtedness does not exceed the amount of their capital stock will not be affected by the change. They will still be allowed to deduct the entire amount of interest paid on their indebtedness. Corporations whose indebtedness is greater than their capital stock will be benefited by the change. Formerly they could deduct interest only on an amount of indebtedness not exceeding their capital stock; the change permits them further to deduct interest on one-half of the amount by which the indebtedness exceeds the capital stock. For example, a corporation with an interest bearing indebtedness of \$300,000 and a capital stock of

\$200,000 was under the corporation tax law permitted to deduct interest on only \$200,000 of its indebtedness. Under the new law it will be permitted to deduct interest paid on \$250,000.

It may be pointed out, however, that while there may have been a reason for limiting the interest deduction under the corporation tax law, which imposed no tax on individuals, there is no good reason for doing so under the income tax law, which taxes both corporations and individuals. Under the new law the Government receives a tax on all the interest paid by the corporations, subject to the exemption and deductions allowed the recipients of the interest, and only the net income of the corporations after deducting all interest paid should be taxed. As it is there is a double tax laid on the interest paid by the corporations in excess of the amount which they are allowed to deduct from their gross income. The second tax on the same interest coming out of the corporation treasury is paid by the stockholders in addition to the tax on the net income proper. However, the law is very clear on this point and will have to be lived up to even if it is not altogether just.

**Interest on indebtedness secured wholly by collateral the subject of sale in the ordinary business of the corporation making the return** may be deducted, irrespective of the amount of indebtedness, as a part of the "expense of doing business." Examples of such indebtedness are money borrowed on real estate by a real estate company, on securities pledged by a bond house, on automobiles pledged by an automobile manufacturing or selling company, on flour pledged by a milling company and so on.

Interest paid on such indebtedness is not to be reported under the Interest deduction but under the Expenses deduction. This is of especial importance because a corporation with such indebtedness and also some indebtedness not secured by collateral of the nature mentioned would

evidently be permitted to enter under the Interest deduction the interest on its unsecured indebtedness up to an amount not exceeding one-half of its unsecured interest bearing indebtedness and paid-up capital stock outstanding at the close of the year.

**Distinction between Interest and Rentals:** In connection with the subject of Interest it is opportune to direct attention to the fact that under certain conditions interest payments become rentals and credit therefor may be taken as "payments required to be made as a condition to the continued use or possession of property." This is a very important distinction, as there is no limit to the amount of rental payments for which credit may be claimed, so long as the propriety of the payments themselves is unquestioned, whereas there is a definite limit to the amount of interest payments for which credit will be allowed.

Under the corporation tax law it was ruled that interest paid on a mortgage outstanding against a property at the time of its purchase (provided the mortgage is not assumed by the purchaser) would not be included in interest payments but could be treated as a payment necessary to the continued possession of the property. This ruling will doubtless be regarded as a precedent to be followed under the income tax law. Especially public service corporations which hold part or all of the property operated under leases providing that as rental the lessee shall pay the interest on bonds or a guaranteed dividend on stock of the lessor company outstanding at the time of making the lease will find this construction of these payments as rentals to be a most important subject for consideration when making their income tax returns.

**Dividends Received from Other Corporations:** The corporation tax law permitted corporations to deduct from gross income the dividends received on the stocks of other corporations held by the reporting corporation. The purpose of this deduction was obviously to avoid again taxing

income which had already been taxed once as part of the income of the corporations which paid the dividends.

The new income tax law, however, makes no provision for deducting dividends received before determining the net income on which the tax should be paid. Hence, holding companies particularly will be seriously affected, as their subsidiary companies will be taxed on their net income and the holding companies will also be taxed on the same income when received by them in the form of dividends from their subsidiary companies.

**Income Tax paid by corporations on interest on "tax free" bonds or other obligations** will not be allowed as a deduction from the net income of corporations. The new law is very specific on this point. Clauses in bonds issued after the passage of the law guaranteeing the payment of interest without deduction for any taxes whatever are invalid as against Federal income tax. The subject of "Tax Free" Bonds has been more fully dealt with in an earlier section of this article.

### **Rate of Tax**

The rate of tax on taxable net income of corporations is 1 pct., the same as under the corporation tax law. There is no super-tax on corporate incomes.

### **Time of Payment**

Corporations filing returns for the calendar year are to be notified of the amounts of tax assessed against them by June 1st. The tax must be paid not later than June 30th.

A corporation filing return for a fiscal year which does not coincide with the calendar year must pay the tax assessed against it within 120 days after the date upon which it is required to file its return. This would make the last date for payment 180 days after the close of its fiscal year.

### **Penalty for Delinquent Tax**

Taxes remaining unpaid after June 30th, or after 120 days from the date on which return is required to be filed, and after ten days from notice and demand thereof by collector, will be increased 5 pct. on the amount of tax unpaid and interest at 1 pct. per month from due date.

### **Deduction of Tax on Corporate Payments**

On and after November 1, 1913, all corporations and associations, including those which do not have to pay a tax on their corporate net income, and whether acting for themselves or on behalf of some one else (such as trust companies), must deduct the normal tax of 1 pct. from payments of "rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual gains, profits, and income of (any) person exceeding \$3,000 for any taxable year" and pay it over to the Government. The normal tax is to be deducted from all payments of interest on bonds and mortgages, or deeds of trust or other similar corporate obligations whether payable annually or at shorter or longer intervals irrespective of whether or not such interest amounts to \$3,000. The tax is not to be deducted from payments of dividends.

The law is very clear that tax is not to be deducted from payments *to* a corporation for its own account. The law does not, however, specifically state that tax is not to be deducted when a corporation is acting as agent or trustee for an individual recipient nor do the regulations recently promulgated by the Treasury Department indicate that deduction of tax at source of an individual's income is to be waived if a corporation is acting as his agent.

Inasmuch as this subject vitally affects individuals as much as corporations, it has already been rather fully considered in connection with the obligations of individuals.

To avoid repetition the reader is referred to those sections of this article dealing with

Deduction of Tax at Source of Income, page 25,  
Tax Not to be Deducted from Dividends, page 32,  
Tax Not to be Deducted from Payments to Corporations,  
page 32,  
Personal Liability for Deductible Tax, page 33,  
Exemption from or Abatement of Tax Deductible at  
Source, page 33.  
Tax Free Bonds, page 35, and  
Returns for Tax Deducted at Source, page 38.

### **Neglected, Refused, or False Returns**

Any corporation neglecting or refusing to make a return at the specified time or making a false return is liable to a penalty not exceeding \$10,000.

In addition to this penalty, the tax assessed against a corporation neglecting or refusing to make a return will be increased 50 pct. The tax assessed in the case of a fraudulent return will be increased 100 pct.

A failure to make a return of tax deducted from corporate payments will render the corporation responsible therefor liable to a fine of not less than \$20 nor more than \$1,000.

Any officer of a corporation who makes a false or fraudulent return or statement with intent to escape tax is guilty of a misdemeanor and subject to a fine not exceeding \$2,000, or imprisonment not exceeding one year, or both, with the costs of prosecution.

In cases of neglect or refusal to make return and in cases of false returns, the Commissioner of Internal Revenue will, upon discovery thereof at any time within three years after return is due, make a return based upon the best information he can obtain and will then assess the tax. Collectors may summon persons for examination and require the production of books and records to ascertain the information needed to make a correct return.

In cases of sickness or absence an extension of thirty



days beyond the last date for filing a return may be obtained. It is desirable that, when an extension is necessary, application therefor be made before the return is due.

## APPENDIX

### ILLUSTRATION OF CALCULATION OF INCOME TAX ON A DIVERSIFIED INCOME

#### GROSS INCOME:

##### INCOME FROM BUSINESS AND OTHER SOURCES

###### AT WHICH TAX IS NOT DEDUCTED:

Share of profits in a mercantile firm.....	\$73,500.00	
Income from coal mining operations.....	12,000.00	
Salary as treasurer of lumber company.....	2,500.00	
Interest on \$5,000 loan to individual.....	300.00	
Interest on real estate mortgage from an indi- vidual.....	1,750.00	
Interest on deposits.....	150.00	
Rent of real estate .....	600.00	
		\$90,800.00

##### DIVIDENDS ON CAPITAL STOCKS OF DOMESTIC CORPORATIONS:

Manufacturing corporation.....	\$18,000.00	
Pipe line company.....	2,800.00	
Railroad company.....	1,200.00	
		22,000.00

##### INTEREST ON "TAX FREE" BONDS:

Railroad company.....	\$15,000.00	
Electric light companies.....	20,000.00	
		35,000.00

NOTE.—Tax on these bonds has been paid by the corporations which issue them and the full amount of the interest received by the bondholder, but for the purposes of the personal return it is to be assumed that the tax (\$350) was deducted.

##### INCOME ON WHICH THE TAX HAS BEEN DEDUCTED AT SOURCE

(all corporate interest payments and every other income payment, such as interest, rent, salary, etc., exceeding \$3,000 for the year):

Bonds of lumber company (not containing "tax free" clause).....	\$500.00
Rent of factory building.....	5,500.00
Salary as president of manufacturing corporation.	15,000.00

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Interest on real estate mortgage.....	\$3,150.00
Interest on Japanese Government bonds.....	625.00
Dividends on stock of Mexican Mining Co.....	2,000.00
	<hr/> \$26,775.00

NOTE.—The tax on this group of items was deducted by the payors in the case of the first four items and in the case of the last two items by the bankers with whom they were deposited for collection. Total tax so deducted at source, \$267.75.

## INTEREST ON TAX-EXEMPT BONDS:

U. S. Panama 2's.....	\$500.00
Philippine Government Bonds.....	600.00
School District Bonds.....	250.00
Township Road and Bridge Bonds.....	300.00
	<hr/>
	<u>\$1,650.00</u>

NOTE.—Apparently the law does not require that income from tax-exempt sources be shown at all in the return; it is shown hereon as a memorandum merely to emphasize the fact that it is exempt.

Total Gross Income.....	<hr/> \$174,575.00
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## ALLOWABLE DEDUCTIONS:

1. Repairs and maintenance of real estate.....	\$250.00		
Expenses of coal mining operation other than direct mining costs.....	1,500.00		
	<hr/>		
		\$1,750.00	
2. Interest paid on borrowed money.....	2,750.00		
3. Taxes paid: Personal property.....	\$1,000.00		
Real estate.....	1,650.00		
	<hr/>		
		2,650.00	
4. Loss by fire in excess of insurance.....	400.00		
5. Uncollectible note .....	1,500.00		
6. Allowance for depletion of coal mine. \$6,000.00 (5 pct. of selling value at mine of coal mined during the year.)			
Allowance for depreciation of mining plant.....	2,500.00		
Allowance for depreciation of other buildings owned.....	1,000.00	9,500.00	18,550.00
	<hr/>	<hr/>	<hr/>

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Total Net Income. ....	\$156,025.00
7. Corporate dividends (normal tax paid by corporations on their corporate incomes) . . . . .	\$22,000.00
8. Income on which tax paid at source. ....	61,775.00
9. Specific exemption (for bachelor or widower) . . . . .	3,000.00
	<u>86,775.00</u>

Remaining Net Income on which normal tax must be paid personally. .... \$69,250.00

## TAX ON FOREGOING INCOME:

To be paid personally:

1 pct. on \$69,250.00. .... \$692.50

Additional Tax:

1 pct. on. ....	\$30,000.00	\$300.00
2 pct. on. ....	25,000.00	500.00
3 pct. on. ....	25,000.00	750.00
4 pct. on. ....	56,025.00	2,241.00
	<u>\$136,025.00*</u>	<u>3,791.00</u>

Total to be paid personally. .... \$4,483.50  
Amount already deducted from income received. .... 267.75

Total tax imposed on this individual. .... \$4,751.25

NOTE. The foregoing illustration is based on the income for an entire year. It is to be borne in mind that for 1913 the tax is only on income for the period March 1st to December 31st and only five sixths of the \$3,000 or \$4,000 exemption will be allowed, and also that the provision for the deduction of tax at source of income has been in effect only since November 1st.

\* Total net income, \$156,025, less \$20,000 subject only to normal tax.

## INCOME TAX GUIDE

Form  
1000.TREASURY DEPARTMENT,  
INTERNAL REVENUE—INCOME TAX.  
Ed. 50,000—F. C. G. Oct. 25-13.

FORM OF CERTIFICATE TO BE PRESENTED WITH COUPONS OR INTEREST ORDERS STATING WHETHER OR NOT EXEMPTION IS CLAIMED UNDER PARAGRAPH C, SECTION 2, OF THE FEDERAL INCOME TAX LAW.

I do solemnly declare that I, \_\_\_\_\_  
 a citizen or resident of the United States, and residing at \_\_\_\_\_  
 am the owner of \$ \_\_\_\_\_ bonds of the denomination of \$ \_\_\_\_\_ each,  
 Nos. \_\_\_\_\_  
 of the \_\_\_\_\_  
 known as \_\_\_\_\_ bonds, from which were detached  
 the accompanying interest coupons, due \_\_\_\_\_, 191\_\_\_\_, amounting to  
 \$ \_\_\_\_\_, or upon which there matured \_\_\_\_\_, 191\_\_\_\_, \$ \_\_\_\_\_  
 of registered interest.

I (do not) now claim with respect to the income represented by said interest, the benefit  
 of a deduction of \$ \_\_\_\_\_ allowed under paragraph C, Section II, of the Federal  
 Income Tax Law, the total exemption to which I am entitled thereunder being \$ \_\_\_\_\_

Date, \_\_\_\_\_, 191\_\_\_\_ Name, \_\_\_\_\_

Form  
1001.TREASURY DEPARTMENT,  
INTERNAL REVENUE—INCOME TAX.  
Ed. 50,000—F. C. G. Oct. 25-13.

CERTIFICATE TO BE FURNISHED BY ORGANIZATIONS NOT SUBJECT TO TAX ON INTEREST AT SOURCE.

I, \_\_\_\_\_, the \_\_\_\_\_ of the \_\_\_\_\_,  
 a \_\_\_\_\_ of \_\_\_\_\_, located at \_\_\_\_\_, do solemnly  
 declare that said \_\_\_\_\_ is the owner of \$ \_\_\_\_\_  
 bonds of the denomination of \$ \_\_\_\_\_ each, Nos. \_\_\_\_\_  
 of the \_\_\_\_\_ known as \_\_\_\_\_  
 \_\_\_\_\_ bonds, from which were detached the accompanying  
 coupons, due \_\_\_\_\_, 191\_\_\_\_, amounting to \$ \_\_\_\_\_, or upon which  
 there matured \_\_\_\_\_, 191\_\_\_\_, \$ \_\_\_\_\_ of registered interest, and that  
 under the provisions of the Income-tax law of October 3, 1913, said interest is exempt from  
 the payment of taxes collectible at the source, which exemption is hereby claimed.

Date \_\_\_\_\_, 191\_\_\_\_ Name \_\_\_\_\_  
 Address \_\_\_\_\_ Of \_\_\_\_\_  
 (Post office.) (Official position.)  
 (Name of organization.)

Form  
1002.TREASURY DEPARTMENT,  
INTERNAL REVENUE—INCOME TAX.  
Ed. 50,000—F. C. G. Oct. 25-13.

FORM OF CERTIFICATE TO BE PRESENTED WITH COUPONS OR INTEREST ORDERS WHEN NOT ACCOMPANIED BY CERTIFICATE OF OWNERS.

I, \_\_\_\_\_, the \_\_\_\_\_ of the \_\_\_\_\_,  
 of \_\_\_\_\_, do solemnly declare that said \_\_\_\_\_  
 has (or have) purchased or accepted for collection the accompanying coupons or interest orders  
 amounting to \$ \_\_\_\_\_, and which represent interest matured on \$ \_\_\_\_\_ of bonds of the  
 \_\_\_\_\_, and that \_\_\_\_\_ received said coupons or  
 orders for registered interest from \_\_\_\_\_ of \_\_\_\_\_  
 and that no certificate of ownership accompanied said coupons or interest orders, and  
 \_\_\_\_\_ hereby acknowledges responsibility of withholding therefrom the  
 normal income tax of 1 per cent, in accordance with the regulations of the Treasury Department.

Name \_\_\_\_\_  
 (Collecting agency.)

By \_\_\_\_\_  
 (Signature of officer duly authorized to sign, and his official position.)

Date \_\_\_\_\_, 191\_\_\_\_ Address \_\_\_\_\_  
 (Give full address.)

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Date....., 191..... Address.....

## INCOME TAX GUIDE

Form  
1006.FORM OF CERTIFICATE TO BE FILED BY PERSONS, FIRMS, OR ORGANIZATIONS REQUIRED TO  
WITHHOLD AND PAY SAID TAX OTHER THAN THE DEBTOR AT THE SOURCE.TREASURY DEPARTMENT,  
INTERNAL REVENUE TAX,  
BR. 50,000—F. O. No. 3-13.

To \_\_\_\_\_, Collector of Internal Revenue,  
(Name of collector of internal revenue.)

I, \_\_\_\_\_ of the \_\_\_\_\_  
(Name.) (Official title, if any.)

\_\_\_\_\_ (Give address and designate district.)  
(Person, firm, or organization.)

of \_\_\_\_\_, do solemnly declare that I (we) received  
(Post-office address.)

of \_\_\_\_\_ \$\_\_\_\_\_, same being income derived  
(Name from whom received.)

from \_\_\_\_\_, belonging to \_\_\_\_\_  
(State source, whether rent, salary, or other source.)

\_\_\_\_\_ and that the tax thereon, amounting to \$\_\_\_\_\_,  
(Address.)

to which said person is subject, has been withheld at the source of said income by \_\_\_\_\_  
(Name of person withholding.)

(Signed) \_\_\_\_\_

Address \_\_\_\_\_  
(Post-office address.)

Date, \_\_\_\_\_, 191 \_\_\_\_\_  
2-7274 (City and State.)

Form  
1097.FORM FOR CLAIMING EXEMPTION AT THE SOURCE AS PROVIDED IN PARAGRAPH C, SECTION 2, OF  
THE FEDERAL INCOME-TAX LAW OF OCTOBER 3, 1913.TREASURY DEPARTMENT,  
INTERNAL REVENUE TAX,  
BR. 50,000—F. O. No. 3-13.

To \_\_\_\_\_  
(Give name of withholding agent.)

\_\_\_\_\_ (Post-office address.)

I hereby serve you with notice that I \_\_\_\_\_ am  
single—married and living with my wife—husband, and now claim the benefit of the exemption  
(Strike out so as to show status correctly.)

of \$\_\_\_\_\_, as allowed in paragraphs C and D of section 2 of the Federal income-tax  
law of October 3, 1913 (my total exemption under said paragraphs being \$\_\_\_\_\_).

Signed: \_\_\_\_\_

Address: \_\_\_\_\_  
(Street and number.)

Date: \_\_\_\_\_, 191 \_\_\_\_\_  
2-7275 (City and State.)

Form  
1009.FORM OF OATH REQUIRED OF A WITHHOLDING AGENT WHEN ACTING FOR ANOTHER IN FILING  
RETURN AND MAKING APPLICATION FOR DEDUCTIONS ALLOWABLE UNDER PARAGRAPH B, AS  
PROVIDED IN PARAGRAPH E, SECTION 2, OF THE FEDERAL INCOME-TAX LAW OF OCTOBER 3, 1913.TREASURY DEPARTMENT,  
INTERNAL REVENUE TAX—INCOME TAX,  
BR. 50,000—F. O. No. 3-13.

I hereby swear (or affirm) that I have sufficient knowledge of the affairs and property of  
\_\_\_\_\_ to enable me to make a full and complete  
(Naming person and address for whom acting.)

return for \_\_\_\_\_ and that the return of income and application for  
(Naming person.)

deductions made by me are true and accurate.

(Signed) \_\_\_\_\_

Address \_\_\_\_\_  
(Street and number.)

Date: \_\_\_\_\_, 191 \_\_\_\_\_  
(City and State.)

Signed and sworn to before \_\_\_\_\_, 191 \_\_\_\_\_

# INCOME TAX GUIDE

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TREASURY DEPARTMENT,  
INTERNAL REVENUE—INCOME TAX,  
Form 1000—24, 53,550—P. C., NOV. 3-13.

## UNITED STATES INTERNAL REVENUE

### FORM OF RETURN FOR MAKING APPLICATION FOR DEDUCTIONS,

AS PROVIDED BY PARAGRAPHS B AND E, SECTION 2 OF  
THE FEDERAL INCOME-TAX LAW OF OCTOBER 3, 1913

To \_\_\_\_\_  
(Name of withholding agent)

\_\_\_\_\_  
(Street and number)

\_\_\_\_\_  
(Town or city) (State)

I hereby solemnly declare that the following is a true and correct return of my gains, profits, and income from all other sources for the calendar year ended December 31, 191 (for the year 1913 the period to be covered is only for ten months, from March 1 to December 31), and a true and correct return of deductions asked for under paragraph B of section 2 of the act of October 3, 1913, and I hereby claim deductions as shown below.

Amount of gains, profits, interest, rents, royalties, profits from copartnerships, and income from all other sources whatsoever	\$	%	%	%	%
<b>DEDUCTIONS</b>					
1. The amount of necessary expenses actually paid in carrying on business, except business expenses of partnerships, and not including personal, living, or family expenses	\$				
2. All interest paid within the year on personal indebtedness of taxpayer					
3. All national, State, county, school, and municipal taxes paid within the year (not including those assessed against local benefits)					
4. Losses actually sustained during the year incurred in trade or arising from fires, storms, or shipwreck and not compensated for by insurance or otherwise					
5. Debts due which have been actually ascertained to be worthless and charged off within the year					
6. Amount representing a reasonable allowance for the exhaustion, wear, and tear of property arising out of its use or employment in the business, not to exceed in the case of mines 5 per cent of the gross value of the output for the year for which the computation is made, but not including the expense of restoring property or making good the exhaustion thereof, for which an allowance is or has been made					
7. The amount received as dividends upon the stock or from the net earnings of any corporation, joint-stock company, association, or insurance company which is taxable upon its net income					
8. The amount of income, the tax upon which has been paid or withheld for payment at the source of income					
<b>Total deductions</b>	\$				

(Signed) \_\_\_\_\_

Date: \_\_\_\_\_, 191 Address \_\_\_\_\_

NOTE.—Money or other things of value, disposed of by gift, donation, or endowment, shall not be deducted or be made the basis for a deduction from the income of persons or corporations in their tax returns under the income-tax law.

2-7071



## RECORD OF INCOME

### Suggestions for Using the Following Pages

The record of income provided for on the following pages is not necessarily intended to be a complete cash account. It is designed for the convenience of those persons who do not care to keep a complete set of personal accounts but who will need to keep a memorandum of all income received and of certain payments and losses in order to be able to prepare the return required by the Government at the end of each year.

An illustration of the manner in which the record is to be used appears on the following pages. The illustration is necessarily much condensed and no dates have been inserted. In practice the entire year's interest on a given bond, for instance, would not be collected at one time; one-half would be collected, say, on February 1st and the other half on August 1st. Salary and rents would usually be received in monthly instalments and so on.

Enter the amount of each item of income in the appropriate column as shown by the heading. Interest on bonds containing a "tax free" clause should be entered in the Taxed column; the tax has been paid at the source when the corporation assumes the payment thereof. Only income from bonds of the United States and its possessions and of states and their political subdivisions, from salaries paid by states or their subdivisions, and from compensation for professional services rendered states and their subdivisions should be entered in the entirely exempt column. In order that errors in claiming exemption may be avoided, each amount of income on which exemption from deduction at source is claimed should be entered in the Exemption Claimed Column.

## RECORD OF INCOME

Dates	Details of Income Expenses & Losses	Income Not Taxable at Source			Taxable at Source		Deductions to be Claimed for Expenses & Losses	
		Entirely Exempt	Corporation Dividends	Other Sources	Taxed	Exemption Claimed		
	Interest, 25 M Q Ry 5's				1.250 -			
	Income from Estate in Trust				22,500 -			
	Divid, 250 shs P.R.R.		750 -					
	Interest, 12 M Ex H.E. L & 6's				720 -			
	" Real Estate Mtg.			2,500 -				
	Rent, 43 W. 3d St.				3,500 -			
	" 905 Saline St			600 -				
	Taxes, 43 W. 3d. St.						525 -	
	" 905 Saline St.						95 -	
	Interest, 20 M U.S. 2's	400 -						
	Fire Loss at 43 W 3d. St \$ 1,500.-							
	Less Insurance 1,300.-						200 -	
	Interest, 9 M City of Quincy 4's	360 -						
	Interest paid on Loans						730	
	Repairs, 905 Saline St.						60 -	
	Salary				2,000 -	4,000 -		
	Depreciation of property:							
	43 W. 3d. St.						600 -	
	905 Saline St.						112 50	
		760 -	750 -	3,100 -	29,970 -	4,000 -	2,322 50	
<u>Summary for the Year.</u>								
	Income on which Normal Tax is yet to be paid					3,100 -		
	Less. Deductions Claimed					2,322 50		
	Tax @ 1 pct on					777 50	7 78	
	Income on which Normal Tax is already paid:							
	Corporation Dividends					750 -		
	Income Taxed at Source					29,970 -		
	Income Exempt from Normal Tax					4,000 -		
						36,497 50		
	Deduct					20,000 -		
	Additional Tax @ 1 pct on					15,497 50	154 97	
	Total Tax to be paid on personal return						162 75	

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]